LIBRARY
SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
JUN 16 1969
JOHN F. DAVIS, CLERK

No. [redacted] 152.

In the Supreme Court of the United States

OCTOBER TERM, [redacted] 1969

ANGELUS FUNERAL HOME, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

ERWIN N. GRISWOLD,
Solicitor General,
JOHNNIE M. WALTERS,
Assistant Attorney General,
HARRY BAUM,
BENNET H. HOLLANDER,
Attorneys,
Department of Justice,
Washington, D.C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 1434

ANGELUS FUNERAL HOME, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (Pet. A1–A15) is reported at 47 T.C. 391. The opinion of the court of appeals (Pet. B1–B10) is reported at 407 F. 2d 210.

JURISDICTION

The judgment of the court of appeals was entered on February 10, 1969. Petitioner's petition for rehearing was denied on February 27, 1969. The petition for a writ of certiorari was filed on May 24, 1969. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether prepayments received by the petitioner corporation from customers under a "Pre-Need Fu-

neral Plan Agreement", which authorized petitioner at its option to use the prepayments for its own benefit, were includible in its gross income for the taxable years in which received.

STATUTE INVOLVED

The pertinent provisions of Sections 61, 441, 446 and 451 of the Internal Revenue Code of 1954 are set forth in the Appendix, *infra*, pp. 8–9.

STATEMENT

Petitioner, Angelus Funeral Home, is a California corporation engaged in the business of providing funeral and burial services. It files its income tax returns on a calendar year, accrual basis. As a part of its business during the years 1954 and continuing through 1961, petitioner entered into written contracts with individuals. Each agreement, called a "Pre-Need Funeral Plan Agreement", provided for a small down payment at the signing of the contract, and for voluntary payments of additional small amounts each month until a set sum was reached. Petitioner agreed that when the individual died it would apply the total amount paid toward the cost of the individual's funeral. If the individual died at a place where petitioner could not perform its services, petitioner was to transfer the entire sum collected by it to a reputable funeral home which would provide the service. (Pet. A2, B1–B2.)

The payments in issue were paid under a form of agreement, utilized in September 1961 and thereafter, which provided (paragraph 4) that petitioner would hold the sums received "in irrevocable trust." (Pet.

A2–A3, B2–3.) However, the agreement further provided (paragraph 5) that petitioner "at its option," could (Pet. A3–A4, B3)—

> use all or any portion of such sums as collateral or payment for (i) the costs of any capital improvement to then existing mortuary facilities belonging to ANGELUS, and (ii) the acquisition and improvement of real property.

As consideration for the right to use the payments, petitioner agreed (paragraph 6) to pay the contracting individual, at the end of each year, ten percent of the funds paid during that year. Some individuals who had signed previous agreements converted them to the new type in order to receive the ten percent payment. (Pet. A4, B3.) [1]

Petitioner did not report the amounts paid to it under the agreements as income in the year in which the payments were received. Instead, it reported the income only when it was required to fulfill its contractual obligations (Pet. A5, B3–B4). The Tax Court, sustaining the Commissioner's determination, found that the agreement petitioner had adopted in September 1961 gave it an unrestricted right to use the payments for specified purposes beneficial to it, and accordingly held that such payments were taxable in the years received (Pet. A12–A15). The court of appeals affirmed (Pet. B1–B10).

---

[1] An earlier agreement, not in issue, did not contain paragraphs 5 and 6 of the agreement here in issue (Pet. A3, B2). The Tax Court found that taxpayer was a true trustee under this earlier agreement, and that therefore amounts received under that agreement were not taxable in the year of receipt (Pet. A11–A12, B3–B4). The Commissioner did not appeal from the Tax Court's decision.

ARGUMENT

The decision below, affirming that of the Tax Court, turns upon the construction of a service contract between petitioner and its customers, and is in accord with established tax accounting principles governing the proper taxable year for reporting advance payments received for services to be performed. There is no conflict of decisions, or other occasion for further review by this Court.

1. It is axiomatic that taxable income must be computed on an annual ("taxable year") basis, and that therefore a taxpayer (whether reporting on the cash or accrual method of accounting) who receives income without restriction as to its use must report it in the year received even though he may later be required to restore the income. Sections 441 and 451, Internal Revenue Code of 1954, Appendix, *infra*, pp. 8–9; North *American Oil* v. *Burnet*, 286 U.S. 417; *Security Mills Co.* v. *Commissioner*, 321 U.S. 281; *United States* v. *Lewis*, 340 U.S. 590; *Healy* v. *Commissioner*, 345 U.S. 278. It is equally settled, as a corollary of the annual accounting rule, that prepayments for future services or goods, received without restriction as to their use, are reportable in the year of receipt notwithstanding that the recipient taxpayer is contractually obligated to perform the services or deliver the goods in a later year in consideration for the prepayments. *American Automobile Assn.* v. *United States*, 367 U.S. 687; *Schlude* v. *Commissioner*, 372 U.S. 128; *Hagen Advertising Displays, Inc.* v. *Commissioner*, decided March 3, 1969 (69–1 U.S.T.C., par. 9254). Cf. *Franklin Life Insurance*

Co. v. *United States*, 399 F. 2d 757 (C.A. 7), certiorari denied, 393 U.S. 1118.

After analyzing the two types of funeral service contracts ("Pre-Need Funeral Plan Agreement") between petitioner and its customers—those entered into before September 1961 and those entered into afterward—the Tax Court concluded that prepayments under the earlier type (not involved on this appeal) were received and held in trust by petitioner for the benefit of the customer until his death and hence were not reportable in the year of receipt, but that prepayments under the later type of agreement (here involved) were not so received and held and therefore were reportable in the year of receipt. Petitioner's contention that the courts below erred in treating the later prepayments as includible in petitioner's gross income for the year of receipt disregards both the terms of the later agreement and the controlling decisions. The later agreement, as distinguished from the earlier one, imposed no restraint upon petitioner's right to use the prepaid funds for designated purposes beneficial to it (acquisition or improvement of land and other facilities); on the contrary, it expressly granted petitioner the "option" to use the funds for such purposes. (Paragraphs 5–6; Pet. A3–A4, B3.) The mere recitation elsewhere in the agreement that the funds were to be held "in trust" (paragraph 4) must be read in conjunction with the broad option granted to use the funds for petitioner's own benefit; and when so read it becomes clear, as both courts below pointed out, that petitioner had the right to use the funds at any time for its own benefit under the later agreement. If any

doubt otherwise existed regarding petitioner's right to use the prepayments for its own benefit, it is dispelled by petitioner's obligation under the agreement to pay its customers ten percent of the prepayments "in consideration for its right to use" the prepayments. (Pet. A4, B3.)

2. The decision below is not in conflict with any other decision. Cases involving option payments applicable against the purchase price if the option is exercised, upon which petitioner chiefly relies (Pet. 14–15), present the question whether the option payment is to be treated by the optionor as ordinary income or as part of the capital gain on the sale—the determination of which must await the exercise or nonexercise of the option. The question here is not whether an option payment represents ordinary income or capital gain, but when (*i.e.*, in which taxable year) a prepayment of ordinary income under a service contract must be reported.

The "security deposit" cases upon which petitioner also relies (Pet. 16–17), involve the receipt and deposit of monies in trust. They apply to the funds petitioner received under the earlier (pre-September 1961) agreements, as to which the Tax Court ruled in petitioner's favor, not to the prepayments received under the later and different agreements involved on this appeal. As for the "borrowed money" cases relied upon (Pet. 18–22), the assertion of conflict rests upon the self-serving premise—contrary to the concurrent findings of both courts below—that the prepayments in question constituted loans from peti-

tioner's customers, rather than advance payments for services.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.
JOHNNIE M. WALTERS,
Assistant Attorney General.
HARRY BAUM,
BENNET N. HOLLANDER,
Attorneys.

JUNE, 1969.

APPENDIX

Internal Revenue Code of 1954:

SEC. 61. GROSS INCOME DEFINED.

(a) *General Definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

* * * * *

[26 U.S.C. 1964 ed., Sec. 61.]

SEC. 441. PERIOD FOR COMPUTATION OF TAXABLE INCOME.

(a) *Computation of Taxable Income.*—Taxable income shall be computed on the basis of the taxpayer's taxable year.

(b) *Taxable Year.*—For purposes of this subtitle, the term "taxable year" means—

(1) the taxpayer's annual accounting period, if it is a calendar year or a fiscal year;

* * * * *

[26 U.S.C. 441.]

SEC. 446. GENERAL RULE FOR METHODS OF ACCOUNTING

(a) *General Rule.*—Taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books.

(b) *Exceptions.*—If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of

the Secretary or his delegate, does clearly reflect income.

(c) *Permissible Methods.*—Subject to the provisions of subsections (a) and (b), a taxpayer may compute taxable income under any of the following methods of accounting—

(1) the cash receipts and disbursements method;

(2) an accrual method;

(3) any other method permitted by this chapter; or

(4) any combination of the foregoing methods permitted under regulations prescribed by the Secretary or his delegate.

* * * * *

[26 U.S.C. 446.]

SEC. 451. GENERAL RULE FOR TAXABLE YEAR OF INCLUSION.

(a) *General Rule.*—The amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

* * * * *

[26 U.S.C. 451.]

U.S. GOVERNMENT PRINTING OFFICE: 1969